



**State Investment Commission**  
**Monthly Meeting Minutes**  
**Wednesday, March 23, 2016**  
**9:00 a.m.**  
**Room 205, State House**

The Monthly Meeting of the State Investment Commission (SIC) was called to order at 9:08 a.m., Wednesday, March 23, 2016 in Room 205, State House.

## **I. Roll Call of Members**

The following members were present: Mr. Robert Benson, Mr. J. Michael Costello, Mr. Thomas Fay, Mr. Frank Karpinski, Ms. Marie Langlois, Ms. Faith LaSalle, Mr. Thomas Mullaney, Ms. Marcia Reback and Treasurer Seth Magaziner. Ms. Paula McNamara was absent.

Also in attendance: Mr. Thomas Lynch of Cliffwater, alternative investment consultant; Mr. John Burns, Mr. David Glickman, Ms. Christy Fields and Mr. Allan Emkin of Pension Consulting Alliance (PCA), general consultant; Mr. Don Napier and Mr. Chris Godwin of GenCap America; Mr. David Iden and Mr. Matthew DiCrocce of TIAA; Mr. Andrew Linberg of Institutional Shareholder Services; Mr. Gregory Balewicz of State Street Global Advisors; Ms. Sally Dowling of Adler Pollock & Sheehan P.C., legal counsel; Ms. Anne-Marie Fink, Chief Investment Officer; Mr. Jeff Padwa, Chief of Staff and members of the Treasurer's office staff.

Treasurer Magaziner called the meeting to order at 9:08 a.m.

## **II. Approval of Minutes**

On a motion by Mr. Fay and seconded by Ms. Reback, it was unanimously

**VOTED: to approve the draft of the minutes of the February 24, 2016 meeting of the State Investment Commission.**

## **III. Review of Portfolio Valuation Standards**

Treasurer Magaziner introduced Mr. Burns of Pension Consulting Alliance to provide an overview of portfolio valuation standards. Mr. Burns explained that asset pricing and liquidity are two basic aspects of the valuation discussion. Auditors and the industry classify assets into three levels based on the methodology used for determining their value. Level One assets are very liquid and have accessible pricing mechanisms. Good examples are securities traded on the stock market with multiple sources providing price quotes. Level Two assets are less liquid, as they lack a regular market-pricing mechanism. Level Three assets, such as real estate, are very illiquid and have less reliable pricing mechanisms. Mr. Burns shared an analysis of the portfolio classified by level, as identified by the managers. Mr. Burns noted the discretion managers have in making these determinations, with some similar assets being classified differently by different managers. Ms. Fink stressed the importance of going beyond the classifications to better understand the characteristics and liquidity of ERSRI's portfolio.

Mr. Fay asked about restrictions on liquidity of commingled fund holdings within the portfolio. Ms. Fink said that domestic assets can be traded daily and State Street Global Advisors (SSgA) preferred that international assets be traded twice a month, though could trade more frequently if necessary. Mr. Fay asked what legal restrictions SSgA would apply in a crisis situation and if these would prevent complete redemption of assets. Mr. Balewicz of SSgA answered that fiduciary responsibilities require SSgA to act in the best interest of all commingled fund participants and there may be some timing restrictions as a result. Mr. Burns noted that when determining liquidity, pricing considerations have a significant influence. An asset that can be sold, but only at a substantially discounted price, may not be considered liquid.

Mr. Lynch of Cliffwater added that though investment managers have significant discretion, a third-party auditor must approve of the level classification applied to assets. He then provided an overview of the level breakdowns within the private equity and hedge fund portfolios. Private equity assets are largely categorized as Level Three and hedge funds are mainly a mix of Level One and Level Two assets. Mr. Lynch provided additional detail based on instances where manager strategy impacts asset categorization.

Ms. Langlois asked about the duration of a typical private equity investment period. Mr. Lynch answered that it was approximately four years. He said that market factors and funded ratios impact this process.

#### **IV. Review of Private Equity Portfolio**

Mr. Lynch began by stating that the private equity portfolio was on track, meeting investment level, diversification and general performance targets. He said that the private equity portfolio has produced strong returns since inception and that the overall strategy is working. Mr. Lynch provided an overview of current portfolio commitments. He said that ongoing and new commitments were well diversified. Foreign currency and downward valuations negatively impacted private equity performance in the second half of 2015. Mr. Lynch said that a number of the best performing funds were recent commitments made since 2009. He continued with a review of funds by sector, vintage year and exposure by strategy.

Mr. Benson asked about indexes against which to compare the portfolio. Mr. Lynch recommended the Cambridge universe, which consists of a wide pool of private equity.

Mr. Lynch recommended an increase to small buyout funds, and Treasurer Magaziner asked which portion of the portfolio should be reduced to fund this increase. Mr. Lynch answered that the large domestic buyout portion should be reduced.

Mr. Lynch concluded by detailing the portfolio by partnership, highlighting that there was no over-exposure to any single partner or manager.

The board members asked questions.

#### **V. Southvest Fund VII Private Equity Recommendation**

Mr. Lynch introduced Mr. Napier and Mr. Godwin of GenCap America, the manager of the Southvest funds, and described Southvest Fund VII as a domestic small buyout fund. Mr. Napier began their presentation by stating that GenCap was based in Nashville and implemented an investment strategy focused on buying small businesses with a history of success and management in place. He compared this process against other managers that sought out startups or technology companies. Mr. Napier said that GenCap has been able to invest at favorable multiples as a result of their strategy. He added that having the incumbent management teams invest alongside GenCap has been a positive driver of success.

Mr. Fay asked about the sellers' motivations. Mr. Napier provided some examples of older or uninvolved owners that were ready to move on. He stated that GenCap's policy of not removing or altering the current management structure, unlike most other private equity firms, was a competitive advantage in winning deals.

Mr. Fay asked about GenCap's exit strategy. Mr. Napier described a professional sales process with multiple bidders to obtain maximum value. Mr. Godwin added that the small size of these businesses allows for opportunities to add value without altering the incumbent management. An example was adding a full-time controller to a company to help streamline the financials or analyze expansion opportunities.

Mr. Benson asked about the leverage GenCap employs. Mr. Napier responded that they deploy leverage but at lower levels than most buyout firms because of the low multiples at which they purchase companies.

Treasurer Magaziner asked about the sourcing of deals. Mr. Godwin explained that GenCap had a national network of thousands of small and mid-size business brokers that understand the types of companies that GenCap will buy.

Mr. Fay asked about larger firms entering GenCap's market. Mr. Napier said that there has not been any significant pressure given the specific area that GenCap specializes in.

Mr. Godwin concluded with a recent case study where GenCap was able to buy an Atlanta company and later sold it for a 5.2 times total cash-on-cash return in 2014.

Mr. Fay asked how large Fund VII was in comparison to past funds. Mr. Napier answered that Fund VII was slated to be \$250m. He added that despite opportunities to pursue larger funds, GenCap was focused on continuing its current successful process. The guests left the room.

On a motion by Mr. Costello and seconded by Ms. Langlois, it was unanimously

**VOTED: to approve a \$30m commitment to Southvest Fund VII L.P.**

## **VI. Luxor Hedge Fund Recommendation**

Mr. Lynch stated that Cliffwater was recommending redemption from Luxor Capital Partners L.P. He explained that overall poor performance, ineffective hedging and overlap with other portfolio holdings were central considerations.

The board members asked questions.

On a motion by Ms. Reback and seconded by Ms. LaSalle, it was unanimously

**VOTED: to approve redemption from Luxor Capital Partners L.P.**

## **VII. Review of Real Estate Portfolio**

Treasurer Magaziner introduced Mr. Glickman and Ms. Fields of PCA to provide an update on the real estate portfolio. Mr. Glickman detailed the state's history of investing in real estate. He highlighted the challenges from losses in non-core investments made in 2007- 2008, and the subsequent hiatus in real estate investments following the 2008 crisis until 2012. Mr. Glickman explained that the real estate allocation now focuses on core, cash-flowing real estate with a smaller allocation to higher return and riskier value-added strategies. Ms. Fields described the performance and diversification of the current real estate portfolio. Mr. Glickman provided a cautiously optimistic outlook for domestic commercial real estate, noting limited new supply and low interest rates.

The board members asked questions.

Mr. Glickman concluded by stating that the current real estate strategy is working as intended.

## **VIII. Institutional Shareholder Services Proxy Voting Policy Recommendation**

Treasurer Magaziner introduced Mr. Linberg of Institutional Shareholder Services (ISS) and briefly described the proxy voting policy recommendation assembled by Treasury staff. He noted it was constructed to provide specific implementation of the SIC's investment policy's approach to corporate governance, environmental and social concerns.

Mr. Linberg explained that ISS uses international research and analysis to help institutions effectively vote proxies. He said that the SIC can control individual votes of interest or have ISS fulfill voting responsibilities according to a predetermined voting policy such as the draft being considered today.

Treasurer Magaziner noted that the draft policy calls for managers to consider risks on environmental and social issues but does not recommend votes that would outright restrict activity.

Mr. Linberg added that the proposed policy also has a focus on diversity in corporate governance. He concluded by saying that ISS will assist Treasury in implementing the proposed policy in a timely and effective manner.

Treasurer Magaziner explained that approving the draft at this meeting would allow the policy to be implemented for the upcoming proxy voting season, and that the policy could be amended at future meetings, if desired for subsequent proxy seasons.

Mr. Fay asked how many companies are operating with an independent board chair. Mr. Linberg answered that over half of the companies within the Russell 3000 and roughly one-third of companies in the S&P 500 have an independent board chair. Mr. Fay also asked what the rationale was for having the default policy position to cast a vote for independent board chairs. Treasurer Magaziner said that it was a nuanced issue without a perfect answer, and that he expected the vote for independent board chairs to be correct more often than not.

On a motion by Mr. Costello and seconded by Mr. Benson, it was unanimously

**VOTED: to approve the proposed proxy voting policy with Institutional Shareholder Services.**

## **IX. TIAA Defined Contribution Plan Line-Up Recommendation**

Treasurer Magaziner introduced Mr. Iden and Mr. DiCroce of TIAA to propose a change to the Defined Contribution Plan (DC Plan) investment line-up. Mr. DiCroce explained that the impetus for the recommendation was changes to money market fund regulations being implemented by the Securities and Exchange Commission in the fall of 2016. As a result, TIAA will no longer be record-keeping retail money market funds such as the Vanguard Prime fund currently included in the state's DC Plan line-up. Mr. DiCroce proposed mapping the Vanguard Prime fund assets into the TIAA Stable Value fund. Mr. DiCroce highlighted minor trading restrictions that would result from the move into the Stable Value Fund. Ms. Fink noted that this transition will affect less than 300 participants who currently hold Vanguard Prime funds. She added that TIAA will communicate with these individuals to inform them of the change and assist with any questions. The board discussed.

On a motion by Mr. Costello and seconded by Mr. Benson, it was unanimously

**VOTED: to approve transitioning the TIAA Prime Funds into the TIAA Stable Value Fund.**

## **X. Review of Securities Litigation**

Treasurer Magaziner introduced Treasury Chief of Staff and General Counsel Jeff Padwa to provide an update of ongoing securities litigation. Mr. Padwa explained that these cases are common among all public retirement systems. A number of law firms monitor securities issues and look for instances where a loss may have occurred as a result of corporate wrongdoing. There is no cost to the state for this monitoring. In describing the active cases, he started with three that have been ongoing for a while. The first is a case against British Petroleum for a 2006 oil spill in Alaska, where the Employees' Retirement System is the lead plaintiff. This case is ongoing following a defeated motion to dismiss.

The second case is against Royal Bank of Scotland (RBS) in England. RBS has successfully pushed for the trial date to be moved back to March of 2017.

Third is a case against Fortis, a European bank. The case was settled on March 14, though it is unclear what the settlement result will be for ERSRI.

Then Mr. Padwa described cases have been filed by the current administration. One case alleges that the management of Plains All-America, a security in the MLP portfolio, made misrepresentations prior to and following an oil spill.

Next, this administration brought an action against a number of primary dealers in the Treasury market. This case resulted from a Justice Department investigation, and about thirty other entities have joined in this case.

Finally, there is a case against Volkswagen resulting from their emissions issue. There could be multiple jurisdictions where this case is filed, and ERSRI's role is being worked out.

The board asked questions.

## **XI. Meeting Location Discussion**

Treasurer Magaziner asked the members of the Commission if they had any concerns with the parking and accessibility of the Statehouse meeting location. Ms. Fink added that the Warwick Treasury office was a potential alternative. The board members discussed, and a preference to keep the meetings at the Statehouse was indicated.

## **XII. Legal Counsel Report**

There was no legal counsel report.

## **XIII. Chief Investment Officer Report**

Ms. Fink reviewed the performance of the portfolio for February, stating it was down 0.2% for the month. The plan underperformed slightly relative to the benchmark and the basic 60/40 portfolio, impacted by dramatic moves in equities with indexes down 6% early in the month only to largely recover by the end of the month. This whipsaw move affected overall performance, particularly for equity hedge funds. Next, she discussed performance over longer time frames, noting the plan outperforms the 60/40 on both risk and return over three and five years. She reviewed notable asset class performance. Absolute return funds performed positively in the month. The Quality, Value & Momentum (QVM) factor-tilt fund underperformed its benchmark by one basis point for the month, but has outperformed by roughly 50 basis points from inception. Master Limited Partnerships (MLPs) remain volatile, but strong dividend yields remain an attractive feature of these holdings.

Ms. Fink noted that the 529 Plan transition is ongoing and the program management agreement with Ascensus has been signed.

## **XIV. Treasurer's General Comments**

Treasurer Magaziner recognized Ms. Fink and Ms. Lisa Churchville for their work on the CollegeBoundfund transition. He added that within the SIC's draft proxy voting policy, there was a decision to put a focus on board member diversity. Treasurer Magaziner described academic research that shows evidence of a correlation between diversity and investment performance.

There being no other business to come before the Board, on a motion by Mr. Costello and seconded by Mr. Benson the meeting adjourned at 11:57 a.m.

Respectfully submitted,

**Seth Magaziner,  
General Treasurer**